SUPREME COURT, U.S.
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No. 127.

IN THE

Supreme Court of the United States

October Term, 1967.

READING COMPANY,

Petitioner,

v.

FRANCIS SHUNK BROWN, 3RD, Trustee of the Estate of I. J. KNIGHT REALTY CORP., Bankrupt,

Respondent,

and

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

BRIEF OF RESPONDENT FRANCIS SHUNK BROWN, 3rd, TRUSTEE.

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FRANCIS SHUNK BROWN, 3RD, TRUSTEE OF THE ESTATE OF I. J. KNIGHT REALTY CORP., BANKRUPT,

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BRIEF FOR RESPONDENT FRANCIS SHUNK BROWN, 3RD, TRUSTEE.

OPINIONS BELOW.

The opinion of the Court of Appeals for the Third Circuit is reported at 370 F. 2d 624 (3d Cir. 1967), and is printed at R. 50. The opinion of the District Court for the Eastern District of Pennsylvania is reported at 242 F. Supp. 337 (E. D. Pa. 1965), and is printed at R. 36. The opinion of the Honorable Thomas J. Curtin, Referee in Bankruptcy is not reported, but is printed at R. 23.

QUESTION PRESENTED.

Is an unliquidated negligence claim against a receiver which arises during a Chapter XI proceeding entitled to a first priority as part of the "costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition" as expressed in Section 64a(1) of the Bankruptcy Act (11 U. S. C. § 104(a)), elsewhere referred to in Section 62a(1) (11 U. S. C. § 102(a)(1)) as "the actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates . . ."

STATUTES INVOLVED.

The pertinent statutory provisions are Sections 17a, 62a(1), 63a(7), 64a and 77n of the Bankruptcy Act, 11 U. S. C. §§ 35(a), 102(a)(1), 103(a)(7), 104(a) and 205(n) respectively. All of these sections have been printed in the appendix to the Brief for Petitioner, pages 23-26 inclusive, except Sections 17a and 77n. Section 17a and 77n are printed in the appendix to this Respondent's Brief, pages 15 to 17.

It is submitted that there are no constitutional issues present here.

STATEMENT OF THE CASE.

On November 16, 1962, I. J. Knight Realty Corporation filed a petition in the United States District Court for the Eastern District of Pennsylvania for an arrangement under Chapter XI of the Bankruptcy Act. Francis Shunk Brown, 3rd, Esquire, was appointed receiver to operate the business of the debtor, whose principal asset was an 8-story industrial structure known as the Fretz Building, located at 10th and Diamond Streets in Philadelphia, Pennsylvania.

On January 1, 1963, a fire of unusual intensity, fanned by winds of exceptionally high velocity completely destroyed the Fretz Building. It was a twelve-alarm fire, and, as the Reading Company alleges, the biggest in the history of Philadelphia (R. 7). The fire also damaged or destroyed adjoining property, including property of the Reading Company.

Thereafter, the Reading Company filed a claim in the bankruptcy proceeding styled a claim for "administration expenses due to the negligence of the Receiver in operation of the business of the debtor" (R. 4, 5). On May 14, 1963, the corporation, being unable to function without the building, was adjudicated a bankrupt pursuant to a voluntary consent to adjudication. The receiver was elected trustee, and as such filed a petition to expunge the Reading Company's claim as not being a "cost or expense of administration" as that term is used in the Bankruptcy Act. The trustee and the Reading Company submitted the issues presented by the trustee's petition on the basis of a case stated (R. 21).

Referee Thomas J. Curtin granted the prayer of the trustee's petition in an opinion and order which holds that the Reading Company's claim does not qualify as a cost or

expense of administration under Section 64a(1) and is not provable as an unsecured claim under Section 63 of the Act (R. 23). In an opinion and order dated June 9, 1965, the Honorable Francis L. Van Dusen of the District Court for the Eastern District of Pennsylvania, affirmed Referee Curtin's order (R. 36). Subsequently, a majority of the United States Court of Appeals for the Third Circuit affirmed Judge Van Dusen's order (R. 50, 370 F. 2d 624).

The total of the Reading Company's claim is $559,730.83 (R. 21). Similar property damage negligence claims exceed $3,500,000. In the case stated (R. 21, 22), it was agreed that federal tax claims totaled $244,953.91; and other claims, both secured and unsecured, are roughly itemized totalling $379,207.70 (R. 22). It was also agreed therein that the trustee would have between $630,000 and about $845,000 to distribute.

SUMMARY OF ARGUMENT.

If this Court were to rule that negligence claims arising during bankruptcy are entitled to the highest priority available in the Bankruptcy Act, the ends of justice would be defeated.

That it is the province of Congress to establish priorities in bankruptcy distribution has been firmly recognized by this Court. That these should be strictly adhered to has likewise been recognized.

Section 64a of the Bankruptcy Act sets forth the order of priorities. These are:

1. The costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition (and a number of other named items);

2. Wages and commissions up to $600 per claimant earned within three months of bankruptcy;

3. Certain expenses of creditors objecting to a discharge;

4. Taxes;

5. Debts and rent owing under certain other laws.

To grant the very highest priority to the negligence claim here would result in all the other priority claims being wiped out, not only in this case but in future cases as well.

That Congress has had a conscious purpose narrowly to interpret the administration expense priority has been recognized by this Court.

Section 63a(7) of the Bankruptcy Act provides that where a suit for negligence has been instituted prior to and is pending at the time the bankruptcy petition is filed, the negligence claim may be proved. Section 77n provides that in railroad receiverships and reorganizations, personal injury claims of injured employees shall be preferred and paid as operating expenses. Apart from these sections, the Bankruptcy Act is silent on proof or allowance of tort claims.

That equity receivership cases furnish no authority for interpretation of the Bankruptcy Act has been recognized by this Court.

ARGUMENT.

1. A Reversal of the Court Below Would Not Do Equity.

A ruling by this Court that any negligence damages which Reading Company can establish are to have the highest priority the statute gives will not produce an equitable result, but quite the reverse.

This case is not concerned with immunity from tort liability. It is concerned only with administration under the Bankruptcy Act. Obviously, that Act cannot furnish a procedure for the payment of claims in full. It reflects only the judgment of Congress as to which claims should be paid first where there are insufficient funds for all. However one may disagree with the pattern adopted by Congress, the legislative intention is manifest, and has been adhered to by the tribunals below. This Court should not engraft onto the legislation affecting distribution a result which Congress does not intend.

Proof of certain claims is provided for in Section 63. The only tort claims which Congress has permitted to be proved are those founded upon ". . . the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy. . . ." (Section 63a(7), 11 U. S. C. § 103(a)(7)). The only tort claims allowed any priority are those of injured railroad employees in railroad reorganizations and receiverships. These are required to be paid out of operating expenses by Section 77n (11 U. S. C. § 205(n)). Since these are the only two instances in which the statute provides for the allowance of tort claims, or even for their proof, the claim presented by Reading Company in this case, which meets neither of these statutory requirements, should not be granted a priority above all others.

The priorities, as listed in Section 64a (11 U. S. C. § 104(a)) are:

1. Costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition (and a number of other items not relevant here);

2. Wages and commissions up to $600 per claimant earned within three months of bankruptcy;

3. Certain expenses of creditors objecting to a discharge;

4. Taxes;

5. Debts and rent owing under certain other laws.

In the present case, and very likely in future cases as well, a reversal of the Court below as requested by Reading Company would mean that there would be nothing left for the payment of any of those priority claimants. If any change is needed in the order of priorities, it should be brought about by Congress, not through litigation. Congress has amended the Bankruptcy Act to reflect changing conditions and changing views (*Collier on Bankruptcy*, 14th Edition, Volume 1, pages 7 to 27 inclusive). Before doing so, it conducts hearings so that those learned in bankruptcy law, and those with first hand experience may have an opportunity to express their views and give Congress assistance in this technical field. Changes should be effected through this procedure, and not by engrafting onto the Act, through litigation, the very radical change which the Reading Company now suggests, but which Congress has never intended.

In *United States v. Speers*, 382 U. S. 266 (1965) this Court recognized that changes in the Act should be made by Congress. The issue, which was not germane to the present

one, was whether a trustee in bankruptcy should be considered a statutory "judgment creditor" so as to prevail over an unrecorded federal tax lien. In holding that he should, this Court, speaking through Mr. Justice Fortas, said at pages 276 and 277:

> "Whether this result is inadvisable need not detain us, for the question is one of policy which in our view has been decided by Congress in favor of the trustee . . . . Should experience indicate that inclusion of the trustee within Section 6323 is inadvisable, the fact will not be lost upon Congress."

The question here is likewise one of policy with respect to tort claims based upon negligence. Congress has enunciated its policy in enacting Sections 63a(7) and 77n. It ". . . knows how to assure the priorities it desires", as the Court below recognized (R. 54). If it should desire to change the law with respect to negligence claims arising during bankruptcy, it will no doubt do so. We cannot and should not assume that it will grant such claims a priority ahead of all the already existing priorities.

If the fire which destroyed the bankrupt's only asset had occurred prior to the Chapter XI proceeding, while the premises were still being operated by the owner, there would have been no question here as to the fate of the property damage claims. If bankruptcy had ensued following such a fire, such claimants, if they had promptly started suit prior to the filing of the petition in bankruptcy, would have been entitled to prove their claims under the provision of Section 63a(7), but they would not have enjoyed any priority status under Section 64a(1). Had they not started suit in time, their claims would not have been provable. In that situation, no contention would or could have been made that any sum realized through fire insurance,

however large, would have been available for the payment of such tort claims ahead of all other claimants. No businessman, whether trustee, receiver or otherwise, would have considered carrying liability insurance in a sum sufficient to cover the property damage caused by this holocaust, even if it were available. This Court is not being asked to decide whether the trustee should have been permitted to carry on the business untrammeled by responsibility for negligence. The question before the Court in this case is the construction of the provisions of the Bankruptcy Act having to do with priorities. This Court has recognized that ". . . if one claimant is to be preferred over others, the purpose should be clear from the statute". *Nathanson, Trustee, v. National Labor Relations Board*, 344 U. S. 25, 29 (1952).

2. The Terms of the Bankruptcy Act Require Affirmance of the Judgment of the Court Below.

This case involves a construction of the Bankruptcy Act and not the principles applicable to any other type of equity proceeding or receivership.[1] This Court recognized the difference in *United States v. Speers*, 382 U. S. 266 (1965), referred to earlier at page 8. Mr. Justice Fortas at 382 U. S. 270 pointed out that a case relied on by the

1. The fire which caused property damage arose during arrangement proceedings under Chapter XI, and not in the ensuing bankruptcy which superseded the Chapter XI proceedings. There is no legal significance in this circumstance so far as the question before this Court is concerned, and none of the parties at any stage of the proceedings have contended otherwise. The reason for this is that Section 302 of the Bankruptcy Act (11 U. S. C. § 702) provides that Chapters I to VII of the Act, which include Sections 1 to 72, apply equally to proceedings under Chapter XI as to bankruptcy. The fact that the trustee has been referred to here and there in the Reading Company's brief as a receiver is therefore of no significance as far as the legal result is concerned.

losing party, *United States v. Gilbert Associates, Inc.*, 345 U. S. 361 (1953), arose out of a state insolvency proceeding, and did not involve a bankruptcy proceeding or the rights of a trustee in Bankruptcy.

This Court has acknowledged the concern of Congress that priorities under the provisions of § 64(a) should be narrowly construed: *Goggin, Trustee v. Division of California Labor Law Enforcement*, 336 U. S. 118 (1948). The case involved a tax claim of the United States which was secured by a perfected lien. At page 127 of 336 U. S., this Court, speaking through Mr. Justice Burton, alluded to the "conscious purpose to give a narrowly limited priority to administration expenses." Essentially the same purpose was recognized in *In The Matter of Connecticut Motor Lines, Inc.*, 336 F. 2d 96 (3d Cir., 1964), relied on by the three tribunals below (R. 28, 41, 53). It was pointed out in that case that Section 64a(1) was not intended as a "catch-all" (336 F. 2d at p. 102).

In support of its argument, Reading Company has cited numerous old railroad reorganization and equity receivership cases. These are not relevant in construing the Bankruptcy Act. They do furnish authority for the quotations from the text writers contained in the Reading Company's brief. These quotations, in turn, apply to equity receiverships. The texts quoted contain many other pages dealing with the Bankruptcy Act, quite separate from those quoted on receiverships. In the discussions of bankruptcy, there is no mention of tort claims as administration expenses: e.g. *9 Am. Jur. 2d, Bankruptcy* (1963), Vol. 9, § 534 and §§ 1626 to 1652; Clark, *Law of Receivers* (3d Ed., 1959), Vol. 4, pp. 1787 to 1935; *Corpus Juris Secundum*, Vols. 8 and 8A, § 451 et seq., especially § 455. *In re Progress Lektro Shave Corp.*, 35 F. Supp. 915 (D. Conn. 1940) and *Bereth v. Sparks*, 51 F. 2d 441 (7th Cir., 1931), cited at

pages 9 and 16 of Reading Company's brief, involve an element of unjust enrichment. To have denied a priority would have been to have deprived claimant of his own property. *Sneeden v. Industrial Commission,* 366 Ill. 552, 10 N. E. 2d 327 (1937), cited at page 14, involved a claim which was allowed not because it sounded in tort, but because specifically authorized by statute. *Vass v. Conron Bros. Co.,* 59 F. 2d 969 (2d Cir., 1932) cited at page 10 by Reading Company, is simply not on point. Judge Hand was not concerned with negligence, as he plainly said; and held only that the bankruptcy court was the proper forum to liquidate the claimant's claim. The portion of the opinion quoted was plainly dictum.[2]

The Reading Company has lost no substantive rights. Section 17a of the Bankruptcy Act (11 U. S. C. § 35) provides that a discharge in bankruptcy releases only provable debts. Those which cannot be proved are not discharged. *Collier on Bankruptcy,* 14th Ed., Vol. 1, § 17.03, pp. 1582 and 1583. The Judicial Code, 28 U. S. C. § 959(a), provides for plenary suits against trustees.[3] The Reading Company has been deprived of no constitutional rights. Congress has considerable discretionary power in bankruptcy: *Remington on Bankruptcy,* 5th Edition, Vol. 1, § 14, pages 29 and 30; *Kuehner v. Irving Trust Co.,* 299 U. S. 445 (1937).

Bankruptcy in the early days affected almost entirely the affairs of merchants and traders. Claims arising out

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2. Of the "large collection of cases" referred to by Reading Company at the top of page 17 (which are 32 in number), none is more recent than 1925. Most show by their names that they are railroad cases.

3. Indeed counsel for the Reading Company have already started one for another client, a subrogated fire insurance carrier: *The Home Insurance Company v. Francis Shunk Brown, III, Receiver and Trustee of the Estate of I. J. Knight Realty Corp.,* Civil Action No. 39079, now pending in the U. S. District Court for the Eastern District of Pennsylvania.

of negligence were rare, created few problems, and went unrecognized: *Schall v. Camors, Trustee,* 251 U. S. 239, 250 (1920). Industry intensified. With this intensification, tort claims inevitably arose; and Congress permitted proof of them under the conditions prescribed in Section 63a(7). It was early discovered that railroads could not operate without accidents occurring to employees: *Farmers Loan and Trust Co. v. C. C. G. & C. Ry. Co.,* 93 F. 543, 551 (4th Cir. 1899). The equity receivership rule recognizing their claims was codified by Congress into the present Section 77(n). Since Congress has recognized negligence claims to this limited extent, it is submitted that this Court should go no farther. If recognition is to be extended beyond the present statutory provisions, the extension should be made by Congress.

CONCLUSION.

For the reasons stated it is respectfully submitted that the judgment of the United States Court of Appeals for the Third Circuit should be affirmed.

Respectfully submitted,

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